UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _______ to _______

Commission file number 001-34385

INVESCO MORTGAGE CAPITAL INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**26-2749336**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
1555 Peachtree Street, N.E., Suite 1800	
Atlanta, Georgia	**30309**
(Address of Principal Executive Offices)	**(Zip Code)**

(404) 892-0896

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer	x	Accelerated filer	¨
Non-Accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of August 8, 2013, there were 135,221,266 outstanding shares of common stock of Invesco Mortgage Capital Inc.

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INVESCO MORTGAGE CAPITAL INC.

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PART I

ITEM 1. FINANCIAL STATEMENTS

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

$ in thousands, except per share amounts	As of June 30, 2013 (Unaudited)	As of December 31, 2012
ASSETS		
Mortgage-backed securities, at fair value	19,806,158	18,470,563
Residential loans, held-for-investment, net of loan loss reserve	1,553,006	
Commercial loans, held-for-investment, net of loan loss reserve	8,954	
Cash and cash equivalents	169,777	286,474
Investment related receivable	902,228	41,429
Investments in unconsolidated ventures, at fair value	36,415	35,301
Accrued interest receivable	77,968	62,977
Derivative assets, at fair value	257,110	6,469
Deferred securitization and financing costs	14,812	
Other investments	10,000	10,000
Other assets	2,149	1,547
Total assets (1)	22,838,577	18,914,760
LIABILITIES AND EQUITY		
Liabilities:		
Repurchase agreements	17,878,893	15,720,460
Asset-backed securities issued	1,432,008	
Exchangeable senior notes	400,000	
Derivative liability, at fair value	304,289	436,440
Dividends and distributions payable	91,528	79,165
Investment related payable	19,340	63,715
Accrued interest payable	23,594	15,275
Collateral held payable	91,368	
Accounts payable and accrued expenses	2,160	877
Due to affiliate	11,902	9,308
Total liabilities (1)	20,255,082	16,325,240
Equity:		
Preferred Stock: par value $0.01 per share, 50,000,000 shares authorized; 7.75% series A cumulative redeemable, $25 liquidation preference, 5,600,000 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	135,356	135,362
Common Stock: par value $0.01 per share, 450,000,000 shares authorized; 135,215,860 and 116,195,500 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	1,352	1,162
Additional paid in capital	2,712,605	2,316,290
Accumulated other comprehensive income	(359,519)	86,436
Retained earnings	66,387	18,848
Total shareholders equity	2,556,181	2,558,098

Non-controlling interest	27,314	31,422
Total equity	2,583,495	2,589,520
Total liabilities and equity	22,838,577	18,914,760

(1) Our consolidated balance sheets include assets of consolidated variable interest entities (VIEs) that can only be used to settle obligations and liabilities of the VIEs for which creditors do not have recourse to the primary beneficiary (IAS Asset I LLC, an indirect subsidiary of Invesco Mortgage Capital Inc.). At June 30, 2013 and December 31, 2012, total assets of the consolidated VIEs were $1,561,001 and $0 respectively, and total liabilities of the consolidated VIEs were $1,435,948 and $0 respectively. See Note 3 for further discussion.

The accompanying notes are an integral part of these consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

$ in thousands, except per share data	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Interest Income				
Mortgage-backed securities	168,736	139,004	329,080	280,964
Residential loans	6,889		7,026	
Commercial loans	60		60	
Total interest income	175,685	139,004	336,166	280,964
Interest Expense				
Repurchase agreements	68,463	56,700	134,792	111,985
Exchangeable senior note	5,622		6,782	
Asset-backed securities issued	5,377		5,456	
Total interest expense	79,462	56,700	147,030	111,985
Net interest income	96,223	82,304	189,136	168,979
Provision for loan losses	663		663	
Net interest income after provision for loan losses	95,560	82,304	188,473	168,979
Other Income				
Gain on sale of investments, net	5,692	6,098	12,404	12,143
Equity in earnings and fair value change in unconsolidated ventures	2,157	1,961	3,747	2,970
Realized and unrealized gain (loss) on interest rate swaps and swaptions	53,314	(1,533)	51,311	(2,043)
Realized and unrealized credit default swap income	180	690	531	1,347
Total other income	61,343	7,216	67,993	14,417
Expenses				
Management fee related party	10,807	8,681	21,161	17,320
General and administrative	3,043	1,045	4,587	2,174
Total expenses	13,850	9,726	25,748	19,494
Net income	143,053	79,794	230,718	163,902
Net income attributable to non-controlling interest	1,493	973	2,455	1,999
Net income attributable to Invesco Mortgage Capital Inc.	141,560	78,821	228,263	161,903
Dividends to preferred shareholders	2,713		5,425	
Net income attributable to common shareholders	138,847	78,821	222,838	161,903

Earnings per share:				
Net income attributable to common shareholders (basic)	1.03	0.68	1.69	1.40
(diluted)	0.95	0.68	1.61	1.40
Dividends declared per common share	0.65	0.65	1.30	1.30

The accompanying notes are an integral part of these consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

$ in thousands, except per share data	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Net income	143,053	79,794	230,718	163,902
Other comprehensive income (loss)				
Unrealized gain (loss) on mortgage-back securities				
Change in fair value	(750,421)	68,820	(835,568)	281,063
Reclassification adjustments for (gains) loss included in gain on sale of investments	39,429	(8,407)	54,441	(11,577)
Unrealized gain (loss) on mortgage-backed securities, net	(710,992)	60,413	(781,127)	269,486
Unrealized gain (loss) on derivatives				
Change in fair value	274,660	(102,233)	257,489	(120,564)
Reclassification adjustments for loss included in unrealized gain (loss) on interest swap and swaptions	37,409	35,868	72,970	71,288
Unrealized gain (loss) on derivatives, net	312,069	(66,365)	330,459	(49,276)
Total Other comprehensive income (loss)	(398,923)	(5,952)	(450,668)	220,210
Comprehensive income (loss)	(255,870)	73,842	(219,950)	384,112
Less: Comprehensive income (loss) attributable to non-controlling interest	2,662	(901)	2,258	(4,685)
Less: Dividends to preferred shareholders	(2,713)		(5,425)	
Comprehensive income (loss) attributable to common shareholders	(255,921)	72,941	(223,117)	379,427

The accompanying notes are an integral part of these consolidated financial statements.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

For the six months ended June 30, 2013

(Unaudited)

						Attributable to Common Shareholders				
	Preferred Stock		Common Stock		Additional	Accumulated Other		Total	Non-	
$ in thousands, except per share amounts	Shares	Amount	Shares	Amount	Paid in Capital	Comprehensive Income (loss)	Retained Earnings	Shareholders Equity	Controlling Interest	Total Equity
Balance at January 1, 2013	5,600,000	135,362	116,195,500	1,162	2,316,290	86,436	18,848	2,558,098	31,422	2,589,520
Net income							228,263	228,263	2,455	230,718
Other comprehensive loss						(445,955)		(445,955)	(4,713)	(450,668)
Proceeds from issuance of common stock, net of offering costs			19,011,054	190	396,131			396,321		396,321
Proceeds from issuance of preferred stock, net of offering costs		(6)						(6)		(6)
Stock awards			9,306							
Common stock dividends							(175,299)	(175,299)		(175,299)
Common unit dividends									(1,852)	(1,852)
Preferred stock dividends							(5,425)	(5,425)		(5,425)
Amortization of equity-based compensation					184			184	2	186
Balance at June 30, 2013	5,600,000	135,356	135,215,860	1,352	2,712,605	(359,519)	66,387	2,556,181	27,314	2,583,495

The accompanying notes are an integral part of this consolidated financial statement.

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INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

$ in thousands	**Six Months Ended June 30, 2013**	**2012**
Cash Flows from Operating Activities		
Net income	230,718	163,902
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of mortgage-backed securities premiums and discounts, net	97,379	55,914
Amortization of residential loan and asset-backed-securities premiums	164	
Amortization of commercial loan origination fees	(9)	
Origination fee received	145	
Provision for loan losses	663	
Unrealized (gain) loss on interest swap and swaptions	(24,152)	2,043
Unrealized loss on credit default swap	568	238
Gain on sale of mortgage-backed securities	(12,404)	(12,143)
Gain on termination of interest rate swaptions	(27,159)	
Equity in earnings and fair value change in unconsolidated ventures	(3,747)	(2,970)
Amortization of equity-based compensation	186	156
Amortization of deferred securitization and financing costs	857	
Changes in operating assets and liabilities:		
Increase in accrued interest receivable	(15,011)	(2,763)
Increase in other assets	(655)	(413)
Increase (decrease) in accrued interest payable	8,319	(1,218)
Increase (decrease) in due to affiliate	2,419	(52)
Increase in accounts payable and accrued expenses	1,213	987
Net cash provided by operating activities	259,494	203,681
Cash Flows from Investing Activities		
Purchase of mortgage-backed securities	(6,114,762)	(3,635,203)
Distributions from investment in unconsolidated ventures, net	2,633	16,884
Principal payments from mortgage-backed securities	1,572,612	1,144,380
Proceeds from sale of mortgage-backed securities	1,407,453	1,050,554
Payment of premiums for interest rate swaptions	(49,446)	(2,140)
Proceeds from termination of interest rate swaptions	47,855	
Purchase of residential loans	(1,562,819)	
Principal payments from residential loans	8,636	
Origination of commercial loans, net of origination fees	(9,070)	
Net cash used in investing activities	(4,696,908)	(1,425,525)
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	396,503	34
Cost of issuance of preferred stock	(6)	
Restricted cash		57,173
Collateral held payable	91,368	
Proceeds from repurchase agreements	96,451,813	71,270,565
Principal repayments of repurchase agreements	(94,265,538)	(69,982,671)
Proceeds from issuance of exchangeable senior notes	400,000	
Proceeds from issuance of asset-backed-securities	1,440,755	

Principal repayments of asset-backed-securities	(8,413)	
Payments of deferred costs	(15,551)	
Payments of dividends and distributions	(170,214)	(151,871)
Net cash provided by financing activities	4,320,717	1,193,230
Net change in cash	(116,697)	(28,614)
Cash, beginning of period	286,474	197,224
Cash and cash equivalents, end of period	169,777	168,610
Supplement Disclosure of Cash Flow Information		
Interest paid	138,204	113,203
Non-cash Investing and Financing Activities Information		
Net change in unrealized gain (loss) on mortgage-backed securities and derivatives	(450,668)	220,210
Net change in unconsolidated ventures		2,495
Net change in restricted cash		2,627
Dividends and distributions declared not paid	91,528	75,942
(Receivable) / payable for mortgage-backed securities sold / purchased, net	(921,299)	169,784
Repurchase agreements, not settled	(27,842)	393

The accompanying notes are an integral part of these consolidated financial statements.

INVESCO MORTGAGE CAPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1 Organization and Business Operations

Invesco Mortgage Capital Inc. (the Company) is a Maryland corporation focused on investing in, financing and managing residential and commercial mortgage-backed securities and mortgage loans. The Company invests in residential mortgage-backed securities (RMBS) for which a U.S. Government Agency such as the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) guarantees payments of principal and interest on the securities (collectively Agency RMBS). The Company s Agency RMBS investments include mortgage pass-through securities and collateralized mortgage obligations (CMOs). The Company also invests in RMBS that are not issued or guaranteed by a U.S. government Agency (non-Agency RMBS), commercial mortgage-backed securities (CMBS), and residential and commercial mortgage loans. The Company is externally managed and advised by Invesco Advisers, Inc. (the Manager), a registered investment adviser and an indirect, wholly-owned subsidiary of Invesco Ltd. (Invesco), a leading independent global investment management firm.

The Company conducts its business through IAS Operating Partnership LP (the Operating Partnership) as its sole general partner. As of June 30, 2013, the Company owned 99.0% of the Operating Partnership and Invesco Investments (Bermuda) Ltd., a direct, wholly-owned subsidiary of Invesco, owned the remaining 1.0%.

The Company finances its Agency RMBS, non-Agency RMBS and CMBS investments through short-term borrowings structured as repurchase agreements. The Company has secured commitments with a number of repurchase agreement counterparties. The Company finances its residential loans through the issuance of asset-backed securities. In addition, the Company may use other sources of financing including committed borrowing facilities and other private financing.

The Company is taxed as a real estate investment trust (REIT) for U.S. federal income tax purposes under the provisions of the Internal Revenue Code of 1986, as amended (Code). To maintain the Company s REIT qualification, the Company is generally required to distribute at least 90% of its taxable income to its shareholders annually.

Note 2 Summary of Significant Accounting Policies

Basis of Quarterly Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, promulgated by the Securities and Exchange Commission (the SEC). In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods presented have been included. Certain disclosures included in the Company s annual report on Form 10-K are not required to be included on an interim basis in the company s quarterly reports on Forms 10-Q. The Company has condensed or omitted these disclosures. The interim consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and related notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2012, which was filed with the SEC on March 1, 2013. The results of operations for the period ended June 30, 2013 are not necessarily indicative of the results to be expected for the full year or any other future period.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its subsidiaries and variable interest entities (VIEs) in which the Company is the primary beneficiary. The underlying loans owned by the VIEs are shown under residential loans on our consolidated balance sheet. The asset-backed securities (ABS) issued to third parties by the VIEs are shown under asset-backed securities issued. In our consolidated statements of operations, we record interest income on the residential loans owned by the VIEs and interest expense on the ABS issued by the VIEs. All intercompany balances and transactions have been eliminated.

Variable Interest Entity

A VIE is an entity that lacks one or more of the characteristics of a voting interest entity. A VIE is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The determination of whether an entity is a VIE includes both a qualitative and quantitative analysis. The Company reassesses its initial evaluation of an entity as a VIE upon the occurrence of certain reconsideration events. The entity that consolidates a VIE is known as its primary beneficiary and is generally the entity with (i) the power to direct the activities that most significantly impact the VIE s economic performance, and (ii) the right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could be significant to the VIE. For VIEs that do not have substantial ongoing activities, the power to direct the activities that most significantly impact the VIE s economic performance may be determined by an entity s involvement with the design of the VIE.

Use of Estimates

The accounting and reporting policies of the Company conform to U.S. GAAP. The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples of estimates include, but are not limited to, estimates of the fair values of financial instruments, interest income on mortgage-backed securities (MBS), allowance for loan losses and other-than-temporary impairment charges. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments that have original or remaining maturity dates of three months or less when purchased to be cash equivalents. At June 30, 2013, the Company had cash and cash equivalents, including amounts restricted, in excess of the FDIC deposit insurance limit of $250,000 per institution. The Company mitigates its risk of loss by actively monitoring the counterparties.

Underwriting Commissions and Offering Costs

Underwriting commissions and direct costs incurred in connection with the Company s initial public offering (IPO) and subsequent stock offerings are reflected as a reduction of additional paid-in-capital.

Deferred Costs

Included in deferred costs are costs associated with the issuance of beneficial interest by consolidated VIEs incurred by the Company and costs incurred in connection with the issuance by the Company of its exchangeable senior notes. These costs may include underwriting, rating agency, legal, accounting and other fees. These deferred costs are amortized as an adjustment to interest expense using the effective interest method, based upon actual repayments of the associated beneficial interest issued to third parties and over the stated legal maturity of the exchangeable senior notes.

Repurchase Agreements

The Company finances its Agency RMBS, non-Agency RMBS and CMBS investment portfolio through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements.

In instances where the Company acquires Agency RMBS, non-Agency RMBS or CMBS through repurchase agreements with the same counterparty from whom such assets were purchased, the Company accounts for the purchase commitment and repurchase agreement on a net basis and records a forward commitment to purchase such assets as a derivative instrument if the transaction does not comply with the criteria for gross presentation. All of the following criteria must be met for gross presentation in the circumstance where the repurchase assets are financed with the same counterparty:

- the initial transfer of and repurchase financing cannot be contractually contingent;
- the repurchase financing entered into between the parties provides full recourse to the transferee and the repurchase price is fixed;
- the financial asset has an active market and the transfer is executed at market rates; and
- the repurchase agreement and financial asset do not mature simultaneously.

If the transaction complies with the criteria for gross presentation, the Company records the assets and the related financing on a gross basis on its consolidated balance sheet, and the corresponding interest income and interest expense in its consolidated statements of operations. Forward commitments are recorded at fair value with subsequent changes in fair value recognized in income. Additionally, the Company records the cash portion of its investment in Agency RMBS and non-Agency RMBS as a mortgage related receivable from the counterparty on its consolidated balance sheet.

Asset-Backed Debt Securities

Asset-backed debt securities are recorded at principal balance net of unamortized premiums or discounts.

Fair Value Measurements

The Company discloses the fair value of its financial instruments according to a fair value hierarchy (Levels 1, 2, and 3, as defined). In accordance with U.S. GAAP, the Company is required to provide enhanced disclosures regarding instruments in the Level 3 category (which require significant management judgment), including a separate reconciliation of the beginning and ending balances for each major category of assets and liabilities.

Additionally, U.S. GAAP permits entities to choose to measure many financial instruments and certain other items at fair value (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are irrevocably recognized in earnings at each subsequent reporting date.

The Company elected the fair value option for its investments in unconsolidated ventures. The Company has the one-time option to elect fair value for these financial assets on the election date. The changes in the fair value of these instruments are recorded in equity in earnings and fair value change in unconsolidated ventures in the consolidated statements of operations.

For assets representing available-for-sale investment securities, any change in fair value is reported through consolidated other comprehensive income (loss) with the exception of impairment losses, which are recorded in the consolidated statement of operations.

Securities

The Company designates securities as held-to-maturity, available-for-sale, or trading depending on its ability and intent to hold such securities to maturity. Trading and securities available-for-sale are reported at fair value, while securities held-to-maturity are reported at amortized cost. Although the Company generally intends to hold most of its RMBS and CMBS until maturity, the Company may, from time to time, sell any of its RMBS or CMBS as part of its overall management of its investment portfolio and therefore classifies its RMBS and CMBS as available-for-sale securities.

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All securities classified as available-for-sale are reported at fair value, based on market prices from third-party sources, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders equity. When applicable, included with available-for-sale securities are forward purchase commitments on to-be-announced securities (TBA). The Company records TBA purchases on the trade date and the corresponding payable is recorded as an outstanding liability as a payable for investments purchased until the settlement date of the transaction. This payable is presented in the Investment related payable line item on the consolidated balance sheet.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis and more frequently when economic or market conditions warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. Consideration is given to (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of recovery in fair value of the security, and (iii) the Company s intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

For debt securities, the amount of the other-than-temporary impairment related to a credit loss or impairments on securities that the Company has the intent or for which it is more likely than not that the Company will need to sell before recoveries are recognized in earnings and reflected as a reduction in the cost basis of the security. The amount of the other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of consolidated shareholders equity in other comprehensive income or loss with no change to the cost basis of the security.

Residential Loans Held-For-Investment

Loans held-for-investment include securitized residential mortgage loans held by VIEs in which we hold a controlling interest and which is included in our consolidated balance sheets, and are carried at cost, net of unamortized premiums and any allowance for loan losses. The Company expects that it will be required to continue to consolidate the VIEs in which such loans are held and generally does not have the authority to sell the residential loans held in the VIEs.

Commercial Loans Held-For-Investment

Commercial loans held-for-investment include mezzanine loans owned by us carried at cost, net of any allowance for loan losses. An allowance for loan losses will be recognized only if past and current events indicate it is probable that all amounts due will not be collected according to the terms of the loan agreement.

Interest Income Recognition

Securities

Interest income on available-for-sale MBS, which includes accretion of discounts and amortization of premiums on such MBS, is recognized over the life of the investment using the effective interest method. Management estimates, at the time of purchase, the future expected cash flows and determines the effective interest rate based on these estimated cash flows and the Company s purchase price. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to uncertainties and contingencies, including the rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the pass through or coupon rate and interest rate fluctuations. In addition, management must use its judgment to estimate interest payment shortfalls due to delinquencies on the underlying mortgage loans. These uncertainties and contingencies are difficult to predict and are subject to future events that may impact management s estimates and its interest income. Security transactions are recorded on the trade date. Realized gains and losses from security transactions are determined based upon the specific identification method and recorded as gain (loss) on sale of available-for-sale securities in the consolidated statement of operations.

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Residential Loans

Interest income from the Company s residential loans is recognized on an accrual basis with the related premiums being amortized into interest income using the effective interest method over the weighted average life of these loans. As needed, these estimated cash flows are updated and a revised yield is computed based on the current amortized cost of the investment. In estimating these cash flows, there are a number of assumptions that are subject to estimation, including the interest rate and timing of principal payments (prepayments, repurchases, defaults and liquidations), the timing and amount of expected credit losses, and other factors. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due or has been individually impaired, at which point the loan is placed on nonaccrual status. Interest previously accrued for loans that have been placed on non-accrual status is reversed against interest income in the period it becomes nonaccrual. Residential loans delinquent more than 90 days or in foreclosure are characterized as delinquent. Cash principal and interest that is advanced from servicers subsequent to a loan becoming greater than 90 days past due or individually impaired is recorded as a liability due to the servicer. When a delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Alternately, nonaccrual loans may be placed back on accrual status if restructured and after the loan is considered re-performing. A restructured loan is considered re-performing when the loan has been current for at least 12 months.

Commercial loans

Interest is recognized as revenue when earned and deemed collectible or until a loan becomes past due based on the terms of the loan agreement with the related originating fees being amortized into interest income using the effective interest method over the life of the loan. Interest received subsequent to a loan becoming past due or impaired is used to reduce the outstanding loan principal balance. When a delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Alternately, loans that have been individually impaired may be placed back on accrual status if restructured and after the loan is considered re-performing. A restructured loan is considered re-performing when the loan has been current for at least 12 months.

Allowance for Loan Losses

Residential Loans Allowance for Loan Losses

For residential loans classified as held-for-investment, an allowance for loan losses is established based on our estimate of credit losses. In calculating the allowance for loan losses, we assess expected losses by estimating the probability of default and expected loss severities on the loans. Reviews are performed at least quarterly. The following factors are considered in evaluating the allowance for loan losses:

- Loan-to-value ratios, property values, credit scores, occupancy status, geographic concentration and other observable data available from third party providers;
- Historical prepayments, default rates and loss severities; and
- Trends in delinquencies, loan liquidations, foreclosure timelines, liquidation expenses, servicer advances of delinquent principal and interest, and other observable data related to the servicing of the loans.

Commercial Loans Allowance for Loan Losses

For commercial loans classified as held-for-investment, we establish a specific allowance for loan losses for loans we have determined to be impaired at the reporting date. An individual loan is considered impaired when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan.

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Our methodology for assessing the adequacy of the allowance for loan losses begins with a formal review of each commercial loan in the portfolio and the assignment of an internal impairment status. Reviews are performed at least quarterly. We consider the following factors in evaluating each loan:

- Loan to value ratios upon origination or acquisition of the loan;
- The most recent financial information available for each loan and associated properties, including net operating income, debt service coverage ratios, occupancy rates, rent rolls, as well as any other loss factors we consider relevant, such as, but not limited to, specific loan trigger events that would indicate an adverse change in expected cash flows or payment delinquency;
- Economic trends, both macroeconomic as well as those directly affecting the properties associated with our loans, and the supply and demand of competing projects in the sub-market in which the subject property is located; and
- The loan sponsor or borrowing entity s ability to ensure that properties associated with the loan are managed and operated sufficiently.

Where an individual commercial loan is impaired, we record an allowance to reduce the carrying value of the loan to the current present value of expected future cash flows discounted at the loan s effective rate, with a corresponding charge to provision for loan losses on our consolidated statements of operations.

Investments in Unconsolidated Ventures

The Company has investments in unconsolidated ventures. In circumstances where the Company has a non-controlling interest but is deemed to be able to exert significant influence over the affairs of the enterprise, the Company utilizes the equity method of accounting. Under the equity method of accounting, the initial investment is increased each period for additional capital contributions and a proportionate share of the entity s earnings and decreased for cash distributions and a proportionate share of the entity s losses.

The Company elected the fair value option for its investments in unconsolidated ventures. The election was made upon initial recognition in the financial statements. The Company has elected the fair value option for the purpose of enhancing the transparency of its financial condition. The Company measures the fair value on the basis of the net asset value per share of the investments.

Dividends and Distributions Payable

Dividends and distributions payable represent dividends declared at the consolidated balance sheet date which are payable to common shareholders, preferred shareholders and distributions declared at the consolidated balance sheet date which are payable to non-controlling interest common unit holders of the Operating Partnership, respectively.

Earnings per Share

The Company calculates basic earnings per share by dividing net income attributable to common shareholders for the period by weighted-average shares of the Company s common stock outstanding for that period. Diluted earnings per share takes into account the effect of dilutive instruments, such as units of limited partnership interest in the Operating Partnership (OP Units), exchangeable debt, and unvested restricted stock, but use the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding.

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income, as presented in the consolidated statements of operations, adjusted for changes in unrealized gains or losses on available for sale securities and changes in the fair value of derivatives accounted for as cash flow hedges.

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Accounting for Derivative Financial Instruments

U.S. GAAP provides disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. U.S. GAAP requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the consolidated balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts, such as credit default swaps, that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting under U.S. GAAP.

Income Taxes

The Company is taxed as a REIT. Accordingly, the Company is generally not subject to U.S. federal and applicable state and local corporate income tax to the extent that the Company makes qualifying distributions to its common shareholders, and provided the Company satisfies on a continuing basis, through actual investment and operating results, the REIT requirements including certain asset, income, distribution and stock ownership tests. If the Company fails to qualify as a REIT, and does not qualify for certain statutory relief provisions, it will be subject to U.S. federal, state and local income taxes and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year in which the Company lost its REIT qualification. Accordingly, the Company s failure to qualify as a REIT could have a material adverse impact on its results of operations and amounts available for distribution to its shareholders.

A REIT s dividend paid deduction for qualifying dividends to the Company s shareholders is computed using its taxable income as opposed to net income reported on the consolidated financial statements. Taxable income, generally, will differ from net income because the determination of taxable income is based on tax regulations and not financial accounting principles.

The Company may elect to treat certain of its future subsidiaries as taxable REIT subsidiaries (TRS). In general, a TRS may hold assets and engage in activities that the Company cannot hold or engage in directly and generally may engage in any real estate or non-real estate-related business. A TRS is subject to U.S. federal, state and local corporate income taxes.

If a TRS generates net income, the TRS can declare dividends to the Company which will be included in its taxable income and necessitate a distribution to its shareholders. Conversely, if the Company retains earnings at a TRS level, no distribution is required and the Company can increase book equity of the consolidated entity. The Company has no adjustments regarding its tax accounting treatment of any uncertainties. The Company currently has no uncertain tax positions.

Share-Based Compensation

The Company has adopted an equity incentive plan under which its independent directors, as part of their compensation for serving as directors, are eligible to receive quarterly restricted stock awards. In addition, the Company may compensate the officers and employees of the Manager and its affiliates under this plan pursuant to the management agreement.

Share-based compensation arrangements include share options, restricted share awards, performance-based awards, share appreciation rights, and employee share purchase plans. Compensation costs relating to share-based payment transactions are recognized in the consolidated financial statements, based on the fair value of the equity or liability instruments issued on the date of grant, for awards to the Company s independent directors. Compensation related to stock awards to officers and employees of the Manager and its affiliates are recorded at the estimated fair value of the award during the vesting period. The Company makes an upward or downward adjustment to compensation expense for the difference in the fair value at the date of grant and the date the award was earned.

Dividend Reinvestment and Share Purchase Plan

The Company has implemented a dividend reinvestment and share purchase plan (the DRSPP). Under the terms of the DRSPP, shareholders who participate in the DRSPP may purchase shares of common stock directly from the Company. DRSPP participants may also automatically reinvest all or a portion of their dividends for additional shares of common stock.

Reclassifications

The presentation of certain prior period reported amounts has been reclassified to be consistent with the current presentation. Such reclassifications had no impact on net income or equity attributable to common shareholders.

Recent Accounting Pronouncements

In January 2013, the FASB issued Accounting Standards Update 2013-01, Clarifying the Scope of Disclosure about Offsetting Assets and Liabilities (ASU 2013-01). ASU 2013-01 clarified Accounting Standard Update 2011-11, Disclosures about Offsetting Assets and Liabilities which was issued in December 2011. Entities will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transaction subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on a basis of U.S. GAAP basis and those entities that prepare their financial statements on the basis of International Financial Reporting Standards (IFRS). The guidance was effective for periods beginning on or after January 1, 2013, and interim periods within those annual periods. The additional disclosure requirements were incorporated into Note 10 Offsetting Assets and Liabilities .

In February 2013, the FASB issued Accounting Standards Update 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income (ASU 2013-02), which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. ASU 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements and is effective prospectively for reporting periods beginning after December 15, 2012. ASU 2013-02 increased our disclosures related to items reclassified out of accumulated other comprehensive income, but did not have an effect on our consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

None

Note 3 Variable Interest Entities

During the six months ended June 30, 2013, we purchased through our indirect subsidiary a controlling interest in four securitization trusts (including three during the quarter ended June 30, 2013) which we determined to be VIEs. The VIEs hold pools of 1,926 fixed rate residential mortgage loans having an initial aggregate principal balance of $1.5 billion and issued a series of ABS

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having an aggregate original principal amount of $1.5 billion payable from the cash flows generated by the pools of residential mortgage loans of which $1.4 billion were sold to unaffiliated third parties and the balance was purchased by the Company. Our interests in the VIEs consist of classes of such ABS having an aggregate original principal balance of $112.3 million, which are either subordinate in payment priority, pay interest only, or are payable from certain designated cash flows from the loans. The Company subsequently sold $5.8 million of the original principal balance to a third party.

In determining if a securitized trust should be consolidated, the Company evaluated whether it was a VIE and, if so, whether the Company s direct involvement in the VIE reflects a controlling financial interest that would result in the Company being deemed the primary beneficiary. The Company concluded that its interest in the securitized trusts purchased during the six months ended June 30, 2013, were VIEs because such interests included the power to direct the activities that most significantly impact the economic performance of the VIEs and the obligation to absorb losses or right to receive benefits that are potentially significant to the VIEs. Accordingly, for financial statement reporting purposes, the Company consolidated the underlying assets and liabilities of the securitization trusts at their fair value and, as such, no gain or loss was recorded upon consolidation. The securitizations are non-recourse financing of the residential mortgage loans held-for-investment. The senior securities issued by the securitization trusts and not purchased by the Company, which were sold to unaffiliated third parties, are presented in the consolidated balance sheet as Asset-backed securities issued.

The Company is not contractually required and has not provided any additional financial support to the VIEs for the period ended June 30, 2013. The following table presents a summary of the assets and liabilities of the VIEs. Intercompany balances have been eliminated for purposes of this presentation.

$ in thousand	June 30, 2013	December 31, 2012
Residential loans, held-for-investment	1,553,006	
Accrued interest receivable	4,761	
Deferred costs	3,234	
Total assets	1,561,001	
Accrued interest and accrued expenses payable	3,940	
Asset-backed securities issued	1,432,008	
Total liabilities	1,435,948	

Note 4 Mortgage-Backed Securities

All of the Company s MBS are classified as available-for-sale and, as such, are reported at fair value, which is determined by obtaining valuations from an independent source. If the fair value of a security is not available from a dealer or third-party pricing service, or such data appears unreliable, the Company may estimate the fair value of the security using a variety of methods including other pricing services, repurchase agreement pricing, discounted cash flow analysis, matrix pricing, option adjusted spread models and other fundamental analysis of observable market factors. At June 30, 2013 and December 31, 2012, all of the Company s MBS values were based on values obtained from third-party pricing services. The following tables present certain information about the Company s investment portfolio as of June 30, 2013 and December 31, 2012.

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June 30, 2013

$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Net Weighted Average Coupon (1)	Period-end Weighted Average Yield (2)	Quarterly Weighted Average Yield (3)
Agency RMBS:								
15 year fixed-rate	1,838,463	95,923	1,934,386	22,062	1,956,448	4.03%	2.23%	2.17%
30 year fixed-rate	10,181,259	674,996	10,856,255	(294,830)	10,561,425	3.92%	2.76%	2.77%
ARM	66,156	1,995	68,151	618	68,769	3.33%	2.38%	2.39%
Hybrid ARM	425,550	9,778	435,328	4,842	440,170	3.15%	2.40%	2.41%
Total Agency pass-through	12,511,428	782,692	13,294,120	(267,308)	13,026,812	3.91%	2.67%	2.67%
Agency-CMO(4)	1,549,436	(1,042,298)	507,138	4,338	511,476	2.83%	2.91%	1.84%
Non-Agency RMBS(5)	4,376,621	(629,749)	3,746,872	3,556	3,750,428	3.85%	3.71%	4.54%
CMBS(6)	4,536,954	(2,021,524)	2,515,430	2,012	2,517,442	3.44%	4.64%	4.72%
Total	22,974,439	(2,910,879)	20,063,560	(257,402)	19,806,158	3.73%	3.12%	3.25%

(1) Net weighted average coupon (WAC) as of June 30, 2013 is presented net of servicing and other fees.
(2) Average yield is based on amortized costs as of June 30, 2013 and incorporates future prepayment and loss assumptions.
(3) Average yield is based on average amortized costs for the three months ended June 30, 2013 and incorporates future prepayment and loss assumptions.
(4) Included in the Agency-CMO are interest-only securities which represent 17.6% of the balance based on fair value.
(5) The non-Agency RMBS held by the Company is 62.1% variable rate, 34.2% fixed rate, and 3.7% floating rate based on fair value.
(6) Included in the CMBS are interest-only securities and commercial real estate mezzanine loan pass-through certificates which represent 8.5% and 1.9% of the balance based on fair value, respectively.

December 31, 2012

$ in thousands	Principal Balance	Unamortized Premium (Discount)	Amortized Cost	Unrealized Gain/ (Loss), net	Fair Value	Net Weighted Average Coupon (1)	Period-end Weighted Average Yield (2)	Quarterly Weighted Average Yield (3)
Agency RMBS:								
15 year fixed-rate	1,964,999	102,058	2,067,057	63,839	2,130,896	4.09%	2.37%	2.37%
30 year fixed-rate	9,168,196	601,592	9,769,788	238,949	10,008,737	4.21%	2.89%	2.88%
ARM	109,937	3,464	113,401	2,365	115,766	3.15%	2.06%	2.02%
Hybrid ARM	556,790	13,493	570,283	16,885	587,168	3.19%	2.18%	2.22%
Total Agency pass-through	11,799,922	720,607	12,520,529	322,038	12,842,567	4.13%	2.77%	2.75%
Agency-CMO(4)	1,322,043	(819,530)	502,513	1,926	504,439	2.89%	2.35%	1.51%
Non-Agency RMBS(5)	3,339,683	(308,885)	3,030,798	48,238	3,079,036	4.20%	4.61%	4.80%
CMBS	1,868,928	24,070	1,892,998	151,523	2,044,521	5.27%	4.96%	4.82%

Total	18,330,576	(383,738)	17,946,838	523,725	18,470,563	4.17%	3.30%	3.27%

(1) Net weighted average coupon as of December 31, 2012 (WAC) is presented net of servicing and other fees.
(2) Average yield based on amortized cost as of December 31, 2012 incorporates future prepayment and loss assumptions.
(3) Average yield based on average amortized cost for the three months ended December 31, 2012 incorporates future prepayment and loss assumptions.
(4) Included in Agency-CMO are interest-only securities which represent 14.1% of the balance based on fair value.
(5) The non-Agency RMBS held by the Company is 79.2% variable rate, 15.5% fixed rate, and 5.3% floating rate based on fair value.

The following table summarizes our non-Agency RMBS portfolio by asset type as of June 30, 2013 and December 31, 2012, respectively:

$ in thousands	**June 30, 2013**	**% of Non-Agency**	**December 31, 2012**	**% of Non-Agency**
Re-REMIC Senior	1,580,196	42.1%	1,844,209	59.9%
Prime	1,346,748	35.9%	754,161	24.5%
Alt-A	793,868	21.2%	468,181	15.2%
Subprime	29,616	0.8%	12,485	0.4%
Total Non-Agency	3,750,428	100.0%	3,079,036	100.0%

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The following table summarizes certain characteristics of our senior Re-REMIC holdings as of June 30, 2013 and December 31, 2012:

	Percentage of Re-REMIC holdings at Fair Value	
Re-REMIC Subordination(1)	June 30, 2013	December 31, 2012
0-10	3.4%	2.1%
10-20	3.4%	3.2%
20-30	14.3%	15.0%
30-40	26.1%	27.0%
40-50	39.7%	40.4%
50-60	8.4%	7.6%
60-70	4.7%	4.7%
Total	100.0%	100.0%

(1) Subordination refers to the credit enhancement provided to the senior Re-REMIC tranche by the junior Re-REMIC tranche or tranches in a resecuritization. This figure reflects the percentage of the balance of the underlying security represented by the junior tranche or tranches at the time of resecuritization. Generally, principal losses on the underlying security in excess of the subordination amount would result in principal losses on the senior Re-REMIC tranche.

The components of the carrying value of the Company s investment portfolio at June 30, 2013 and December 31, 2012 are presented below:

$ in thousands	June 30, 2013	December 31, 2012
Principal balance	22,974,439	18,330,576
Unamortized premium	866,592	788,716
Unamortized discount	(3,777,471)	(1,172,454)
Gross unrealized gains	277,273	563,093
Gross unrealized losses	(534,675)	(39,368)
Fair value	19,806,158	18,470,563

The following table summarizes certain characteristics of the Company s investment portfolio, at fair value, according to estimated weighted average life classifications as of June 30, 2013 and December 31, 2012:

$ in thousands	June 30, 2013	December 31, 2012
Less than one year	82,496	70,044
Greater than one year and less than five years	5,496,854	13,146,577
Greater than or equal to five years	14,226,808	5,253,942
Total	19,806,158	18,470,563

The following tables present the gross unrealized losses and estimated fair value of the Company s MBS by length of time that such securities have been in a continuous unrealized loss position at June 30, 2013 and December 31, 2012, respectively:

June 30, 2013

	Less than 12 Months		12 Months or More		Total	
$ in thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Agency RMBS:						
15 year fixed-rate	471,398	(5,069)	12,035	(452)	483,433	(5,521)
30 year fixed-rate	7,456,237	(368,049)	85,523	(1,010)	7,541,760	(369,059)
ARM	36,557	(227)			36,557	(227)
Hybrid ARM	190,714	(1,334)			190,714	(1,334)
Total Agency pass-through	8,154,906	(374,679)	97,558	(1,462)	8,252,464	(376,141)
Agency-CMO	101,883	(7,584)	10,277	(1,524)	112,160	(9,108)
Non-Agency RMBS	1,746,341	(57,858)	397,715	(13,735)	2,144,056	(71,593)
CMBS	1,133,905	(77,833)			1,133,905	(77,833)
Total	11,137,035	(517,954)	505,550	(16,721)	11,642,585	(534,675)

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December 31, 2012

$ in thousands	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
Agency RMBS:						
15 year fixed-rate	31,269	(279)			31,269	(279)
30 year fixed-rate	1,763,113	(6,469)	78,640	(832)	1,841,753	(7,301)
Total Agency pass-through	1,794,382	(6,748)	78,640	(832)	1,873,022	(7,580)
Agency-CMO	31,719	(7,796)	10,770	(2,812)	42,489	(10,608)
Non-Agency RMBS	516,744	(6,005)	490,503	(12,895)	1,007,247	(18,900)
CMBS	187,349	(1,267)	52,813	(1,013)	240,162	(2,280)
Total	2,530,194	(21,816)	632,726	(17,552)	3,162,920	(39,368)

Gross unrealized losses on the Company s Agency RMBS were $376.1 million at June 30, 2013. Due to the inherent credit quality of Agency RMBS, the Company determined that at June 30, 2013, any unrealized losses on its Agency RMBS portfolio are temporary.

Gross unrealized losses on the Company s MBS-CMO, non-Agency RMBS, and CMBS were $158.5 million at June 30, 2013. The Company does not consider these unrealized losses to be credit related, but rather due to non-credit related factors such as interest rate spreads, prepayment speeds, and market fluctuations. These investment securities are included in the Company s assessment for other-than-temporary impairment on at least a quarterly basis.

The following table presents the impact of the Company s MBS on its accumulated other comprehensive income for the three and six months ended June 30, 2013 and 2012.

$ in thousands	Three Months ended June 30, 2013	Three Months ended June 30, 2012	Six Months ended June 30, 2013	Six Months ended June 30, 2012
Accumulated other comprehensive income from investment securities:				
Unrealized gain on MBS at beginning of period	453,590	207,856	523,725	(1,217)
Unrealized gain (loss) on MBS, net	(710,992)	60,413	(781,127)	269,486
Balance at the end of period	(257,402)	268,269	(257,402)	268,269

During the three months ended June 30, 2013 and 2012, the Company reclassified $39.4 million of net unrealized losses and $8.4 million of net unrealized gains, respectively from other comprehensive income into gain (loss) on sale of investments as a result of the Company selling certain investments.

During the six months ended June 30, 2013 and 2012, the Company reclassified $54.4 million of net unrealized losses and $11.6 million of net unrealized gains, respectively from other comprehensive income into gain on sale of investments as a result of the Company selling certain investments.

The Company assesses its investment securities for other-than-temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other-than-temporary. In deciding whether a security is other-than-temporarily impaired, the Company considers several factors, including the nature of the investment, the severity and duration of the impairment, the cause of the impairment, and the Company s intent that it is more likely than not that the Company can hold the security until recovery of its cost basis.

The Company did not have other-than-temporary impairments for the three and six months ended June 30, 2013 and 2012.

The following table presents components of interest income on the Company s MBS portfolio for the three and six months ended June 30, 2013 and 2012.

For the three months ended June 30, 2013

$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	142,846	(46,956)	95,890
Non-Agency	41,325	2,001	43,326
CMBS	35,670	(6,252)	29,418
Other	102		102
Total	219,943	(51,207)	168,736

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For the six months ended June 30, 2013

$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	286,259	(92,069)	194,190
Non-Agency	77,737	3,142	80,879
CMBS	62,320	(8,452)	53,868
Other	143		143
Total	426,459	(97,379)	329,080

For the three months ended June 30, 2012

$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	127,392	(35,741)	91,651
Non-Agency	25,143	5,126	30,269
CMBS	17,005	100	17,105
Other	(21)		(21)
Total	169,519	(30,515)	139,004

For the six months ended June 30, 2012

$ in thousands	Coupon Interest	Net (Premium Amortization)/Discount Accretion	Interest Income
Agency	249,706	(67,238)	182,468
Non-Agency	53,426	11,054	64,480
CMBS	33,816	268	34,084
Other	(68)		(68)
Total	336,880	(55,916)	280,964

Note 5 Residential Loans Held-for-Investment

The following table details the carrying value for residential loans held-for-investment at June 30, 2013 and December 31, 2012. These loans are held by the VIEs which the Company consolidates.

$ in thousands	June 30, 2013	December 31, 2012
Principal balance	1,518,554	
Unamortized premium, net	35,115	

Recorded investment	1,553,669
Allowance for loan losses	(663)
Carrying value	1,553,006

We consider a number of factors when evaluating the credit risks associated with our residential loans held-for-investment portfolio, including but not limited to year of origination, delinquency status and geographic concentration.

The following table displays residential loans held-for-investment at June 30, 2013 organized by year of origination.

$ in thousands	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**Total**
Portfolio Characteristics:							
Number of Loans	1,304	608			5	1	1,918
Current Principal Balance	1,001,208	514,647			2,213	486	1,518,554
Net Weighted Average Coupon Rate	3.48%	3.50%			3.54%	4.48%	3.49%
Weighted Average Maturity (years)	29.77	29.48			26.00	25.53	29.66
Current Performance:							
Current	1,001,208	513,937			2,213	486	1,517,844
30 Day Delinquent		710					710
60 Days Delinquent							
90+ Days Delinquent							
Bankruptcy/Foreclosure							
Total	1,001,208	514,647			2,213	486	1,518,554

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The following table presents the five largest geographic concentrations of the Company s residential loans at June 30, 2013 based on principal balance:

State	Percent
California	49.7%
Illinois	5.8%
Massachusetts	5.8%
Virginia	4.2%
Maryland	4.2%
Other states (none greater than 4%)	30.3%
Total	100.0%

The following table presents future minimum annual principal payments under the residential loans held-for-investment at June 30, 2013:

$ in thousands Scheduled Principal	June 30, 2013
Within one year	27,207
One to three years	57,575
Three to five years	62,066
Greater than or equal to five years	1,371,706
Total	1,518,554

Allowance for Loan Losses on Residential Loans

For residential loans held-for-investment, we establish an allowance for loan losses. The allowance includes residential loans owned by the consolidated VIEs that we collectively evaluated for impairment.

The following table summarizes the activity in the allowance for loan losses for the quarter ended June 30, 2013:

$ in thousands	June 30, 2013
Balance at beginning of period	
Charge-offs, net	
Provision for loan losses	663
Balance at end of period	663

During the quarter ended June 30, 2013 there were no charge-offs of residential loans.

Note 6 Commercial Loans Held-for-Investment

Commercial loans held-for-investment includes mezzanine loans originated by the Company. These loans are secured by the borrower s ownership interest in a single purpose entity that owns commercial property, rather than a lien on the commercial property. As of June 30, 2013, the Company had one outstanding commercial loan which was newly originated and was not delinquent on payment. The loan was not impaired and no allowance for loan loss recorded.

Note 7 Investments in Unconsolidated Ventures

The Company s non-controlling, unconsolidated ownership interests in these unconsolidated entities are accounted for under the equity method. Capital contributions, distributions, profits and losses of the entities are allocated in accordance with the terms of the entities operating agreements. Such allocations may differ from the stated percentage interests, if any, as a result of preferred returns and allocation formulas as described in such agreements. The Company has made the fair value election for its investments in all unconsolidated ventures. The fair value measurement for the investments in unconsolidated ventures is based on the net asset value per share of the investment, or its equivalent.

Invesco Mortgage Recovery Feeder Fund, L.P. and Invesco Mortgage Recovery Loans AIV, L.P.

The Company invested in certain non-Agency RMBS, CMBS and residential and commercial mortgage loans by contributing equity capital to the Invesco Mortgage Recovery Feeder Fund L.P. managed by the Company s Manager (Invesco IMRF Fund) that received financing under the U.S. government s Public Private Investment Program (PPIP). In March 2012, Invesco IMRF Fund returned substantially all of its proceeds and repaid all financing under the PPIP. The Company is awaiting final distribution from the Invesco IMRF Fund. In addition, the Manager identified a whole loan transaction for the Company, which resulted in the Company s admission into an alternative investment vehicle, the Invesco Mortgage Recovery Loans AIV, L.P. (AIV). The Company s initial commitment in the Invesco IMRF Fund and AIV was $25.0 million. During 2009 and 2010, the Invesco IMRF Fund and AIV accepted additional subscriptions and the Company increased its overall commitment to $100.0 million, which effectively increased the Company s initial ownership interest in the Invesco IMRF Fund and AIV. As of March 31, 2010, the Invesco IMRF Fund stopped accepting investment subscriptions and was deemed closed. The Company made its first contributions to the Invesco IMRF Fund in October 2009. The Company is committed to fund $16.7 million in aggregate of additional capital at June 30, 2013 for the Invesco IMRF Fund and AIV. The Company realized approximately $561,000 (2012: $357,000) and $906,000 (2012: $709,000) of equity in earnings for the three and six months ended June 30, 2013 related to these investments. The Company also had an unrealized gain of $1.3 million (2012: $1.1 million gain) and an unrealized gain of $1.5 million (2012: $1.2 million gain) from these investments for the three and six months ended June 30, 2013.

IMRF Loan Portfolio Member LLC

On September 30, 2011, the Company invested in a portfolio of commercial mortgage loans by contributing $16.9 million, net of distributions, of equity capital to IMRF Loan Portfolio Member LLC (IMRF LLC) a limited liability company managed by AIV. The Company has fully funded its commitment to IMRF LLC. The Company realized approximately $197,000 (2012: $362,000) and $92,000 (2012: $716,000) of equity in earnings and $84,000 (2012: $155,000) of unrealized appreciation and $1.3 million (2012: $307,000) of unrealized appreciation from these investments for the three and six months ended June 30, 2013, respectively.

Note 8 Borrowings

The Company has entered into repurchase agreements and exchangeable senior notes to finance the majority of its portfolio of investments. The following table summarizes certain characteristics of the Company s borrowings as of June 30, 2013 and December 31, 2012:

	June 30, 2013			December 31, 2012		
$ in thousands	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)	Amount Outstanding	Weighted Average Interest Rate	Weighted Average Remaining Maturity (days)
Agency RMBS	12,901,076	0.38 %	18	11,713,565	0.48 %	16
Non-Agency RMBS	2,954,836	1.53 %	44	2,450,960	1.75 %	23
CMBS	2,022,981	1.43 %	21	1,555,935	1.51 %	18
Exchangeable Senior Notes	400,000	5.00 %	1,719		%	
Total	18,278,893	0.79 %	59	15,720,460	0.78 %	17

Repurchase Agreements

The repurchase agreements bear interest at a contractually agreed rate. The repurchase obligations mature and typically reinvest every thirty days to one year. Repurchase agreements are being accounted for as secured borrowings since the Company maintains effective control of the financed assets. Under the repurchase agreements, the respective lender retains the right to mark the underlying collateral to fair value. A reduction in the value of pledged assets would require the Company to provide additional collateral or fund margin calls. In addition, the repurchase agreements are subject to certain financial covenants. The Company is in compliance with these covenants at June 30, 2013.

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The following tables summarize certain characteristics of the Company s repurchase agreements at June 30, 2013 and December 31, 2012:

June 30, 2013 $ in thousands Repurchase Agreement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding	Company MBS Held as Collateral
Credit Suisse Securities (USA) LLC	1,653,408	9.3%	1,979,912
CitiGroup Global Markets Inc.	1,419,251	8.0%	1,568,086
Wells Fargo Securities, LLC	1,292,651	7.3%	1,464,390
Banc of America Securities LLC	1,217,698	6.8%	1,320,420
Morgan Stanley & Co. Incorporated	1,203,310	6.7%	1,288,815
South Street Securities LLC	1,182,146	6.6%	1,232,440
JP Morgan Securities Inc.	890,923	5.0%	1,016,242
RBS Securities Inc.	867,405	4.9%	1,022,809
ING Financial Market LLC	772,567	4.3%	823,250
Goldman, Sachs & Co.	757,543	4.2%	796,202
Pierpont Securities LLC	752,523	4.2%	787,552
HSBC Securities (USA) Inc	744,336	4.2%	774,117
Mitsubishi UFJ Securities (USA), Inc.	704,381	3.9%	731,474
Nomura Securities International, Inc.	629,866	3.5%	670,090
Scotia Capital	566,539	3.2%	590,097
Industrial and Commercial Bank of China Financial Services LLC	542,868	3.0%	571,102
Royal Bank of Canada	535,214	3.0%	606,785
Daiwa Capital Markets America Inc	480,719	2.7%	509,052
BNP Paribas Securities Corp.	438,981	2.5%	454,964
Deutsche Bank Securities Inc.	437,948	2.4%	491,273
Barclays Capital Inc.	252,486	1.4%	269,563
TD Securities	221,167	1.2%	233,741
Mizuho Securities USA Inc.	134,040	0.7%	148,684
KGS-Alpha Capital Markets, L.P.	73,069	0.4%	79,496
Cantor Fitzgerald & Co.	71,723	0.4%	79,130
Guggenheim Liquidity Services, LLC	36,131	0.2%	37,684
Total	17,878,893	100.0%	19,547,370

December 31, 2012 $ in thousands Repurchase Agreement Counterparties	Amount Outstanding	Percent of Total Amount Outstanding	Company MBS Held as Collateral
Credit Suisse Securities (USA) LLC	1,600,331	10.2%	1,919,676
Morgan Stanley & Co. Incorporated	1,275,616	8.1%	1,397,846
Nomura Securities International, Inc.	1,240,231	7.9%	1,350,901
Mitsubishi UFJ Securities (USA), Inc.	941,671	6.0%	990,057
Wells Fargo Securities, LLC	941,556	6.0%	1,079,194
HSBC Securities (USA) Inc	883,726	5.6%	918,551
South Street Securities LLC	819,524	5.2%	871,963
CitiGroup Global Markets Inc.	780,020	5.0%	882,517
Banc of America Securities LLC	728,609	4.6%	838,216
Scotia Capital	708,750	4.5%	744,692
Industrial and Commercial Bank of China Financial Services LLC	634,928	4.0%	690,783
Deutsche Bank Securities Inc.	587,919	3.7%	666,472
ING Financial Market LLC	573,116	3.6%	622,944
JP Morgan Securities Inc.	561,426	3.6%	697,602

Royal Bank of Canada	560,828	3.6%	641,079
BNP Paribas Securities Corp.	488,375	3.1%	516,770
Goldman, Sachs & Co.	468,806	3.0%	509,660
Daiwa Capital Markets America Inc	456,098	2.9%	479,354
Pierpont Securities LLC	437,095	2.8%	463,466
Barclays Capital Inc.	350,688	2.3%	372,708
RBS Securities Inc.	348,741	2.2%	427,183
Mizuho Securities USA Inc.	101,962	0.6%	122,836
Cantor Fitzgerald & Co.	80,466	0.5%	86,961
KGS-Alpha Capital Markets, L.P.	79,052	0.5%	86,241
Guggenheim Liquidity Services, LLC	43,245	0.3%	45,437
TD Securities	27,681	0.2%	33,129
Total	15,720,460	100.0%	17,456,238

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Company MBS held by counterparties as security for repurchase agreements was $19.5 billion and $17.5 billion at June 30, 2013 and December 31, 2012, respectively. This represents a collateral ratio (Company MBS Held as Collateral/Amount Outstanding) of 109% and 111% respectively.

No cash collateral was held by the counterparties at June 30, 2013 and December 31, 2012.

Asset-Backed Securities Issued

During the six months ended June 30, 2013, the Company purchased controlling interests in four securitization trusts (including three during the quarter ended June 30, 2013) which it determined to be VIEs. The securitization trusts securitized residential mortgage loans with an aggregate principal balance of $1.5 billion, and issued $1.5 billion aggregate principal amount of ABS, of which $1.4 billion were sold to unaffiliated third parties and the balance was purchased by the Company. The Company subsequently sold $5.8 million of the original principal balance to a third party. As a result, the ABS issued by the securitization trusts is recorded as a non-recourse liability in the Company s consolidated balance sheet. During the six months ended June 30, 2013, ABS held by unaffiliated third parties was paid down by $8.4 million.

The carrying value of the ABS is based on its amortized cost, which is equal to the remaining principal balance net of unamortized premiums or discounts. The following table provides summary information of the carrying value of the ABS issued, along with other relevant information, at June 30, 2013.

$ in thousands	ABS Outstanding	Residential loans Held as Collateral
Principal balance	1,412,316	1,518,554
Interest-only securities	11,727	
Unamortized premium	10,879	35,115
Unamortized discount	(2,914)	
Loan loss reserve		(663)
Carrying value	1,432,008	1,553,006
Range of weighted average interest rates	2.8% - 3.4%	
Number of series	4	

The following table presents the estimated principal repayment schedule of the VIE s ABS at June 30, 2013, based on expected cash flows of the residential mortgage loans, as adjusted for projected losses on such loans.

$ in thousands Estimated principal repayment	June 30, 2013
Within One Year	249,203
One to Three Years	383,920
Three to Five Years	267,784
Greater Than or Equal to Five Years	511,409
Total	1,412,316

The maturity of the VIE s ABS is dependent upon cash flows received from the underlying residential mortgage loans. The estimate of their repayment is based on estimated principal payments on the underlying loans. This estimate may differ from actual amounts to the extent prepayments and/or loan losses vary. See Note 5 Residential Loans Held-for-Investment for a more detailed discussion of the residential loans collateralizing the VIE s ABS.

Exchangeable Senior Notes

In the first quarter of 2013, a wholly-owned subsidiary of the Company issued $400.0 million in aggregate principal amount of Exchangeable Senior Notes (the Notes) due 2018. The total net proceeds to the Company after deducting financing expenses was $387.9 million.

The terms of the Notes are governed by an indenture (the Indenture) by and among the wholly-owned subsidiary, as issuer, the Company, as guarantor, and The Bank of New York Mellon Trust Company, N.A., as trustee (the Trustee). The Notes bear interest at 5.00% per annum, payable semi-annually in arrears on March 15 and September 15 of each year, beginning September 15, 2013. The Notes may be exchanged for shares of the Company s common stock at the applicable exchange rate at any time prior to the close of business on the second scheduled trading day prior to the maturity date. The initial exchange rate for each $1,000 aggregate principal amount of the Notes is 42.0893 shares of the Company s common stock, equivalent to an exchange price of approximately $23.76 per share. The Notes, including the guaranty and the shares of common stock of the Company issuable upon exchange of the Notes, have not been registered under the Securities Act of 1933. Accrued interest payable on the Notes is approximately $6.1 million as of June 30, 2013.

Note 9 Derivatives and Hedging Activities

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its investments, debt funding, and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company s derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company s known or expected cash receipts and its known or expected cash payments principally related to the Company s investments and borrowings.

The Company also utilizes credit derivatives such as credit default swaps (CDS) to provide credit event protection based on a financial index or specific security in exchange for receiving a fixed-rate fee or premium over the term of the contract. These instruments enable the Company to synthetically assume the credit risk of a reference security, portfolio of securities or index of securities. The counterparty pays a premium to the Company and the Company agrees to make a payment to compensate the counterparty for losses upon the occurrence of a specified credit event.

Although contract-specific, credit events generally include bankruptcy, failure to pay, restructuring, obligation acceleration, obligation default, or repudiation/moratorium. Upon the occurrence of a defined credit event, the difference between the value of the reference obligation and the CDS s notional amount is recorded as a realized loss in the statement of operations.

Our only CDS contract was entered into in the fourth quarter of 2010. We sold protection against losses on a specific pool of non-Agency RMBS in the event they exceed a specified loss limit of 25% of the balance of the non-Agency RMBS on the trade date. The maximum exposure is the remaining unpaid principal balance of the underlying RMBS in excess of the specified loss threshold. In exchange, we are paid a stated fixed rate fee of 3% of the notional amount of the CDS. The remaining notional amount of the CDS at June 30, 2013 is $64.5 million (2012: $103.3 million), and we estimated the fair market value of the CDS to be approximately $950,000 (2012: $1.2 million) at June 30, 2013. As of June 30, 2013, we have not made any payments related to the CDS contract.

At June 30, 2013 and December 31, 2012, the open CDS sold by the Company is summarized as follows:

$ in thousand	**June 30, 2013**	**December 31, 2012**
Fair value amount	950	1,519
Notional amount	64,509	79,806
Maximum potential amount of future undiscounted payments	64,509	79,806
Recourse provisions with third parties		
Collateral held by counterparty	10,080	12,371

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Cash Flow Hedges of Interest Rate Risk

The Company has purchased interest rate swaptions to help mitigate the potential impact of increases or decreases in interest rates on the performance of a portion of the Company s investment portfolio (referred to as convexity risk). The interest rate swaptions provide the Company the option to enter into interest rate swap agreements for a predetermined notional amount, stated term and pay and receive interest rates in the future. The premium paid for interest rate swaptions is reported as an asset in the Company s consolidated balance sheets. The premium is valued at an amount equal to the fair value of the swaption that would have the effect of closing the position adjusted for nonperformance risk, if any. The difference between the premium and the fair value of the swaption is reported in unrealized gain (loss) on interest rate swaps and swaptions, net in the Company s consolidated statement of operations. If a swaption expires unexercised, the loss on the swaption would be equal to the premium paid. If we sell or exercise a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash or the fair value of the underlying interest rate swap received and the premium paid. The Company sold swaptions during the three and six months ended June 30, 2013, realizing a net gain of $27.2 million. For the three and six months ended June 30, 2013, the Company had $25.9 million and $23.9 million of unrealized gain, respectively, which represents the change in fair value of our interest rate swaptions that are recognized directly in earnings.

As of June 30, 2013, the company had the following outstanding interest rate swaptions:

$ in thousands			Option			Underlying Swap		
Swaptions	Expiration	Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive rate	Average Term (Years)
Payer	< 6 Months	23,272	21,628	5.84	1,300,000	3.19%	3M Libor	10.00
Payer	> 6 Months	14,290	35,930	10.88	1,100,000	3.11%	3M Libor	10.00
		37,562	57,558	8.15	2,400,000	3.15%		10.00

$ in thousands	Notional Amount as of January 1, 2013	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount as of June 30, 2013	Amount of Realized Gain, net on Interest Rate Swaps and Swaptions
Swaption Contracts	850,000	3,300,000	(1,750,000)	2,400,000	27,159
Interest Rate Swap	8,000,000	4,500,000	(300,000)	12,200,000	
Total	8,850,000	7,800,000	(2,050,000)	14,600,000	27,159

The Company finances its activities primarily through repurchase agreements, which are usually settled on a short-term basis, usually from one to twelve months. At each settlement date, the Company refinances each repurchase agreement at the market interest rate at that time. Since the interest rate on its repurchase agreements change on a one to twelve month basis, the Company is exposed to changing interest rates. The Company s objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps, designated as cash flow hedges, involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

During the three months ended June 30, 2013, the Company recorded $294,000 of unrealized swap gains (2012: $3,000 of unrealized swap losses) in earnings as hedge ineffectiveness attributable primarily to differences in the reset dates on the Company s swaps versus the refinancing dates of certain of its repurchase agreements.

During the six months ended June 30, 2013, the Company recorded $293,000 of unrealized swap gains (2012: $513,000 of unrealized swap losses) in earnings as hedge ineffectiveness attributable primarily to differences in the reset dates on the Company s swaps versus the refinancing dates of certain of its repurchase agreements.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest is accrued and paid on the Company s repurchase agreements. During the next twelve months, the Company estimates that an additional $173.1 million will be reclassified as an increase to interest expense.

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The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of 126 months.

As of June 30, 2013, the Company had the following interest rate derivatives outstanding, which were designated as cash flow hedges of interest rate risk:

$ in thousands

Counterparty		**Notional**	**Maturity Date**	**Fixed Interest Rate in Contract**
SunTrust Bank		100,000	7/15/2014	2.79%
Deutsche Bank AG		200,000	1/15/2015	1.08%
Deutsche Bank AG		250,000	2/15/2015	1.14%
Credit Suisse International		100,000	2/24/2015	3.26%
Credit Suisse International		100,000	3/24/2015	2.76%
Wells Fargo Bank, N.A.		100,000	7/15/2015	2.85%
Wells Fargo Bank, N.A.		50,000	7/15/2015	2.44%
Morgan Stanley Capital Services, LLC		300,000	1/24/2016	2.12%
The Bank of New York Mellon		300,000	1/24/2016	2.13%
Morgan Stanley Capital Services, LLC		300,000	4/5/2016	2.48%
Citibank, N.A.		300,000	4/15/2016	1.67%
Credit Suisse International		500,000	4/15/2016	2.27%
The Bank of New York Mellon		500,000	4/15/2016	2.24%
JPMorgan Chase Bank, N.A.		500,000	5/15/2016	2.31%
Goldman Sachs Bank USA		500,000	5/24/2016	2.34%
Goldman Sachs Bank USA		250,000	6/15/2016	2.67%
Wells Fargo Bank, N.A.		250,000	6/15/2016	2.67%
JPMorgan Chase Bank, N.A.		500,000	6/24/2016	2.51%
Citibank, N.A.		500,000	10/15/2016	1.93%
Deutsche Bank AG		150,000	2/5/2018	2.90%
ING Capital Markets LLC		350,000	2/24/2018	0.95%
Morgan Stanley Capital Services, LLC		100,000	4/5/2018	3.10%
ING Capital Markets LLC		300,000	5/5/2018	0.79%
JPMorgan Chase Bank, N.A.		200,000	5/15/2018	2.93%
UBS AG		500,000	5/24/2018	1.10%
ING Capital Markets LLC		400,000	6/5/2018	0.87%
The Royal Bank of Scotland Plc	(1)	500,000	9/5/2018	1.04%
CME Clearing House	(8)(9)	300,000	2/5/2021	2.69%
CME Clearing House	(8)(9)	300,000	2/5/2021	2.50%
Wells Fargo Bank, N.A.		200,000	3/15/2021	3.14%
Citibank, N.A.		200,000	5/25/2021	2.83%
HSBC Bank USA, National Association	(7)	550,000	2/24/2022	2.45%
The Royal Bank of Scotland Plc	(6)	400,000	3/15/2023	2.39%
UBS AG	(6)	400,000	3/15/2023	2.51%
HSBC Bank USA, National Association		250,000	6/5/2023	1.91%
HSBC Bank USA, National Association	(2)	250,000	7/5/2023	1.97%
The Royal Bank of Scotland Plc	(3)	500,000	8/15/2023	1.98%
UBS AG	(5)	250,000	11/15/2023	2.23%
HSBC Bank USA, National Association	(4)	500,000	12/15/2023	2.20%
Total		12,200,000		2.09%

(1) Forward start date of September 2013
(2) Forward start date of July 2013

(3) Forward start date of August 2013
(4) Forward start date of December 2013
(5) Forward start date of November 2013
(6) Forward start date of March 2015
(7) Forward start date of February 2015
(8) Forward start date of February 2016
(9) Beginning June 10, 2013, regulations promulgated under The Dodd-Frank Wall Street Reform and Consumer Protection Act mandate that the Company clear new interest rate swap transactions through a central counterparty. Transactions that are centrally cleared result in the Company facing a clearing house, rather than a swap dealer, as counterparty. Central clearing requires the Company to post collateral in the form of initial and variation margin to the clearing house which reduces default risk.

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At June 30, 2013, the Company s counterparties held no cash margin deposits and approximately $288.4 million in Agency RMBS as collateral against its swap contracts. In addition, several counterparties posted securities of approximately $160.1 million and $91.4 million of cash as collateral with the Company. Cash margin posted by the Company and cash margin posted by counterparties that are restricted in use, if any, is classified as restricted cash and the Agency RMBS collateral posted by the Company is included in the total mortgage-backed securities on the Company s consolidated balance sheet. Cash collateral that is not restricted to use by the Company is included in Cash and cash equivalents and the liability to return the collateral is included in Collateral held payable on the consolidated balance sheet. Non-cash collateral posted by counterparties to the Company would be recognized if any counterparty defaults or if the Company sold the pledged collateral. As of June 30, 2013, the Company did not recognize any non-cash collateral held as collateral.

Tabular Disclosure of the Effect of Derivative Instruments on the Consolidated Balance Sheet

The table below presents the fair value of the Company s derivative financial instruments, as well as their classification on the consolidated balance sheet as of June 30, 2013 and December 31, 2012.

$ in thousands

Asset Derivatives				Liability Derivatives			
As of June 30, 2013		As of December 31, 2012		As of June 30, 2013		As of December 31, 2012	
Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value	Balance Sheet	Fair Value
Interest rate swap asset	198,602	Interest rate swap asset		Interest rate swap liability	304,289	Interest rate swap liability	436,440
CDS	950	CDS	1,519				
Swaption	57,558	Swaption	4,950				

Tabular Disclosure of the Effect of Derivative Instruments on the Income Statement

The table below presents the effect of the Company s derivative financial instruments on the statement of operations for the three and six months ended June 30, 2013 and 2012.

Three months ended June 30, 2013

$ in thousands

Derivative type for cash flow hedge	Amount of gain recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of gain recognized in income on derivative (ineffective portion)	Amount of gain recognized in income on derivative (ineffective portion)
Interest Rate Swap	274,660	Interest Expense	37,409	Realized and unrealized gain (loss) on interest rate swaps and swaptions	294

Six months ended June 30, 2013

$ in thousands

Derivative type for cash flow hedge	Amount of gain recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of gain recognized in income on derivative (ineffective portion)	Amount of gain recognized in income on derivative (ineffective portion)
Interest Rate Swap	257,489	Interest Expense	72,970	Realized and unrealized gain (loss) on interest rate swaps and swaptions	293

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Three months ended June 30, 2012

$ in thousands

Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of loss recognized in income on derivative (ineffective portion)	Amount of loss recognized in income on derivative (ineffective portion
Interest Rate Swap	102,233	Interest Expense	35,868	Realized and unrealized gain (loss) on interest rate swaps and swaptions	3

Six months ended June 30, 2012

$ in thousands

Derivative type for cash flow hedge	Amount of loss recognized in OCI on derivative (effective portion)	Location of loss reclassified from accumulated OCI into income (effective portion)	Amount of loss reclassified from accumulated OCI into income (effective portion)	Location of loss recognized in income on derivative (ineffective portion)	Amount of loss recognized in income on derivative (ineffective portion
Interest Rate Swap	120,564	Interest Expense	71,288	Realized and unrealized gain (loss) on interest rate swaps and swaptions	513

Derivative not designated as hedging instrument	Location of unrealized gain recognized in income on derivative	Amount of gain (loss) recognized in income on derivative	
		Three months ended June 30, 2013	Three months ended June 30, 2012
CDS Contract	Realized and unrealized credit default swap income	345	(69)
Swaption Contract	Realized and unrealized gain (loss) on interest rate swaps and swaptions	25,861	(1,530)

Amount of gain (loss) recognized in income on derivative

Derivative not designated as hedging instrument	Location of gain recognized in income on derivative	Six months ended June 30, 2013	Six months ended June 30, 2012
CDS Contract	Realized and unrealized credit default swap income	568	(238)
Swaption Contract	Realized and unrealized gain (loss) on interest rate swaps and swaptions	23,859	(1,530)

Credit-risk-related Contingent Features

The Company has agreements with each of its derivative counterparties. Some of those agreements contain a provision whereby if the Company defaults on any of its indebtedness, including default whereby repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company s agreements with certain of its derivative counterparties provide that if the Company s net asset value declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations with that counterparty. The Company s agreements with certain of its derivative counterparties provide that if the Company s shareholders equity declines by certain percentages over specified time periods, then the Company could be declared in default on its derivative obligations with that counterparty.

The Company s agreements with certain of its derivative counterparties provide that if the Company fails to maintain a minimum shareholders equity or market value of $100 million and $80 million, respectively, then the Company could be declared in default on its derivative obligations with that counterparty.

As of June 30, 2013, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for non-performance risk, related to these agreements was $244.2 million. The

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Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of $288.4 million of Agency RMBS as of June 30, 2013. If the Company had breached any of these provisions at June 30, 2013, it could have been required to settle its obligations under the agreements at their termination value.

The Company was in compliance with all of the financial provisions of these agreements through June 30, 2013.

Note 10 Offsetting Assets and Liabilities

The following tables present information about certain assets and liabilities that are subject to master netting agreements (or similar agreements) and can potentially be offset on the Company s consolidated balance sheets at June 30, 2013 and December 31, 2012.

Offsetting of Derivative Assets

As of June 30, 2013

$ in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet: Financial Instruments (1)	Cash Collateral Received	Net Amount
Derivatives	257,110		257,110	(257,110)		
Total	257,110		257,110	(257,110)		

Offsetting of Derivative Liabilities and Repurchase agreements

As of June 30, 2013

$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet: Financial Instruments (2)(3)	Cash Collateral Posted (2)(4)	Net Amount
Derivatives	304,289		304,289	(304,289)		
Repurchase Agreements	17,878,893		17,878,893	(17,878,893)		
	18,183,182		18,183,182	(18,183,182)		

Offsetting of Derivative Assets

As of December 31, 2012

$ in thousands Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet: Financial Instruments (1)	Gross Amounts Not Offset in the Consolidated Balance Sheet: Cash Collateral Received	Net Amount
Derivatives	6,469		6,469	(6,469)		
Total	6,469		6,469	(6,469)		

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Offsetting of Derivative Liabilities and Repurchase agreements

As of December 31, 2012

$ in thousands Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets presented in the Consolidated Balance sheet	Gross Amounts Not Offset in the Consolidated Balance Sheet: Financial Instruments (2)(3)	Cash Collateral Posted (2)(4)	Net Amount
Derivatives	436,440		436,440	(436,440)		
Repurchase Agreements	15,720,460		15,720,460	(15,720,460)		
	16,156,900		16,156,900	(16,156,900)		

(1) Amounts represent interest rate derivatives in an asset position which could potentially be offset against interest rate derivatives in a liability position at June 30, 2013 and December 31, 2012, subject to a netting arrangement.

(2) Amounts represent collateral pledged that is available to be offset against liability balances associated with repurchase agreements and interest rate derivatives.

(3) The fair value of securities pledged against our borrowing under repurchase agreements was $19.5 billion and $17.5 billion at June 30, 2013 and December 31, 2012, respectively.

(4) Total cash received on our Derivatives was $78.6 million and $0 at June 30, 2013 and December 31, 2012, respectively. Total non-cash collateral received on our Derivatives was $160.1 million and $0 at June 30, 2013 and December 31, 2012, respectively.

In the Company s consolidated balance sheets, all balances associated with the repurchase agreement and derivatives transactions are presented on a gross basis.

Certain of the Company s repurchase agreement and derivative transactions are governed by underlying agreements that generally provide for a right of setoff in the event of default or in the event of a bankruptcy of either party to the transaction. For one repurchase agreement counterparty, the underlying agreement provide for an unconditional right of setoff.

Note 11 Financial Instruments

U.S. GAAP defines fair value, provides a consistent framework for measuring fair value under U.S. GAAP, and Accounting Standards Codification (ASC) Topic 820 expands fair value financial statement disclosure requirements. ASC Topic 820 does not require any new fair value measurements and only applies to accounting pronouncements that already require or permit fair value measures, except for standards that relate to share-based payments.

Valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company s market assumptions. The three levels are defined as follows:

Level 1 Inputs Quoted prices for identical instruments in active markets.

Level 2 Inputs Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs Instruments with primarily unobservable value drivers.

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The fair values on a recurring basis of the Company s MBS and interest rate hedges based on the level of inputs at June 30, 2013 and December 31, 2012 are summarized below:

	June 30, 2013 Fair Value Measurements Using:			
$ in thousands	**Level 1**	**Level 2**	**Level 3**	**Total at Fair Value**
Assets				
Mortgage-backed securities(1)		19,806,158		19,806,158
Investments in unconsolidated ventures			36,415	36,415
Derivatives		256,160	950	257,110
Total		20,062,318	37,365	20,099,683
Liabilities				
Derivatives		304,289		304,289
Total		304,289		304,289

	December 31, 2012 Fair Value Measurements Using:			
$ in thousands	**Level 1**	**Level 2**	**Level 3**	**Total at Fair Value**
Assets				
Mortgage-backed securities(1)		18,470,563		18,470,563
Investments in unconsolidated ventures			35,301	35,301
Derivatives		4,950	1,519	6,469
Total		18,475,513	36,820	18,512,333
Liabilities				
Derivatives		436,440		436,440
Total		436,440		436,440

(1) For more detail about the fair value of our MBS and type of securities, see Note 4 in the consolidated financial statements.

The following table presents additional information about the Company s investments in unconsolidated ventures which are measured at fair value on a recurring basis for which the Company has utilized Level 3 inputs to determine fair value:

$ in thousands	**June 30, 2013**	**December 31, 2012**
Beginning balance	35,301	68,793
Purchases	403	4,218
Sales and settlements	(3,036)	(44,879)
Total net gains / (losses) included in net income		
Realized gains/(losses), net	998	6,813
Unrealized gains/(losses), net	2,749	356
Unrealized gain/(losses), net included in other comprehensive income		

Ending balance	36,415	35,301

The following table presents additional information about the Company s CDS contract which is measured at fair value on a recurring basis for which the Company has utilized Level 3 inputs to determine fair value: